

INFORMATIONAL

Arbitration Awards

NASD Regulation Provides Guidance On The Use Of Installment Payments To Satisfy Arbitration Awards**SUGGESTED ROUTING**

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Legal & Compliance
- Operations
- Senior Management

KEY TOPICS

- Arbitration Awards
- Motions to Vacate
- Nonpayment Of Awards
- Suspension Proceedings

Executive Summary

In August 2000, the National Association of Securities Dealers, Inc. (NASD[®]) published *Notice to Members 00-55* which announced that NASD Dispute Resolution, Inc. (NASD Dispute ResolutionSM) will require firms to certify in writing that they have complied with arbitration awards within 30 days of receipt of the award notice.

This *Notice* is intended to provide guidance to members on the use of installment payments to satisfy arbitration awards, in light of the Securities and Exchange Commission (SEC) Rule 15c3-1 (the Net Capital Rule).

Questions/Further Information

Questions regarding this *Notice* may be directed to Susan M. DeMando, Director, Member Regulation, NASD Regulation, Inc. (NASD RegulationSM), at (202) 728-8411; or Daniel M. Sibears, Senior Vice President, Member Regulation, NASD Regulation, at (202) 728-6911.

Background

Rule 10330(h) of the Code of Arbitration Procedure (Code) requires that all monetary awards shall be paid within 30 days of receipt unless a motion to vacate has been filed with a court of competent jurisdiction. NASD By-Laws, Article VI, Sec. 3 provides for the suspension or cancellation of membership or registration for, among other reasons, the failure to comply with an award of arbitrators properly rendered pursuant to NASD rules, where a timely motion to vacate or modify such award has not been made pursuant to applicable law or where such a motion has been denied; or for failure to comply with a written and

executed settlement agreement obtained in connection with an arbitration or mediation submitted for disposition pursuant to NASD Rule 9510 Series.

Based on these rules, NASD Dispute Resolution will institute a suspension proceeding for failure to pay an arbitration award against the member firm or associated person, unless a basis for nonpayment is established.

In *Notice to Members 00-55*, five possible bases were listed including, "the parties have agreed to installment payments of the amount awarded or have otherwise agreed to settle the action."

Interpretative Guidance

This *Notice* is intended to provide guidance to members that seek to satisfy an arbitration award through the use of installment payments, in light of the Net Capital Rule.

Basis For The Use Of Installment Payments

According to the SEC's interpretation of the Net Capital Rule:

"A broker/dealer that is the subject of an adverse award in an arbitration proceeding should book said award as an actual liability at the time the award is made, even though the appeal process has not been exhausted and no judgment has been rendered, because grounds for revision on appeal are very limited."

An agreement among the parties to installment payments of the amount awarded does not change the requirement to book the award as an actual liability at the time the award is made. While an installment plan indicates the

payment terms of the liability, it does not reduce the liability. A broker/dealer must reflect the entire amount of the arbitration award as a liability.

As a result, the use of installment payments to satisfy an arbitration award is only appropriate when the broker/dealer has sufficient net capital to conduct a securities business after recording the full liability.

Example 1

Claimant Jones received an arbitration award for \$120,000 against Firm ABC. The claimant has agreed to installment payments of \$5,000 per month from the broker/dealer. This payment plan would be permissible for any broker/dealer in the financial position to include the entire \$120,000 as a liability of the firm and still maintain sufficient net capital to continue to conduct a securities business. That is, after recording the entire amount of the

arbitration award as a liability, the firm is still in compliance with the Net Capital Rule.

Example 2

Claimant Smith received an arbitration award for \$60,000 against Firm DEF. The firm has excess net capital of \$40,000. Since the \$60,000 award is greater than the firm's excess net capital, the required recording of the arbitration award will place the firm under its minimum net capital requirement. Installment payments are mute as the firm does not have sufficient net capital to continue to conduct a securities business.

Sub-Loans

An acceptable alternative to the cessation of business is if the claimant is willing to subordinate the amount of the arbitration award pursuant to an approved sub-loan meeting all the conditions of the Net Capital Rule, Appendix D.

However, the NASD will not approve debt sub-loans if, at the time of signing, the firm's debt-to-debt-equity ratio would exceed 70 percent. Therefore, the use of debt sub-loans may not be available to all firms and their claimants.

Members are reminded that for sub-loans to be added back in their net capital computation, they must be approved by their self-regulatory organization. By virtue of subordinating an arbitration award through a sub-loan, claimants become junior to other creditors in the event of the broker/dealer's insolvency. Therefore, claimants should clearly understand the risks associated with any such subordination *prior* to entering into the agreement.

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